

## Long-Term Care Task Force Briefing Paper

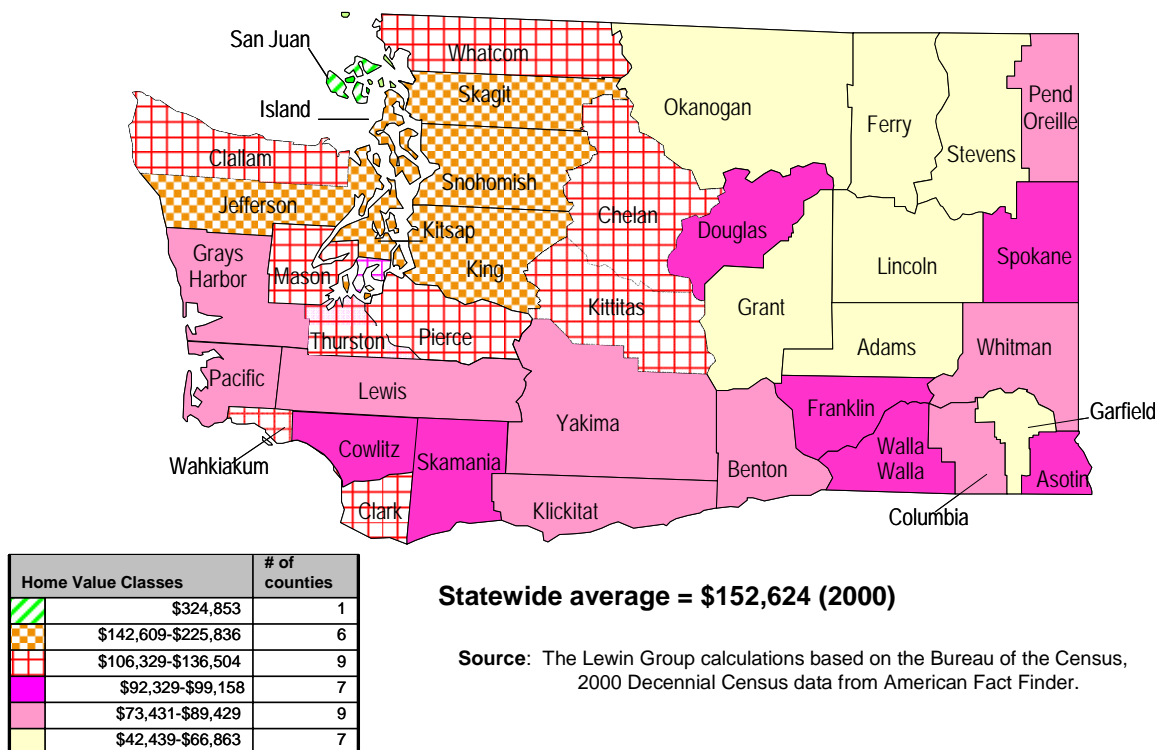
**Issue:** Reverse mortgages and other products that draw on home equity.

### Description:

Americans want to continue to live at home as they grow older, even if they need help with everyday tasks. Many impaired older homeowners, however, are unprepared for the financial challenges that can come with a chronic health condition. This is true not only for “house rich and cash poor” elders, but also for middle-income families who often struggle to pay the extra cost of help at home. If used appropriately, home equity can offer a new financing option to pay for a wide array of services and supports for older Americans who want to “age in place.”

For many seniors, home equity is the most important financial resource to increase their resilience to the financial shocks that can come with declining health. In 2004, about 76 percent of people age 65 and older in the State of Washington were homeowners. Many have accumulated substantial amounts of home equity, over \$242,000 on average in 2004, including families whose other retirement resources may be very modest.<sup>1</sup> Nationally, more than half the net worth of seniors - over \$2 trillion - is currently illiquid in their homes and other real estate.

**Average Home Value for Washington Households Age 65 and Above in 2000**



<sup>1</sup> Bureau of the Census 2004 American Community Survey. The map provides 2000 data because the American Community Survey includes detail for only six of Washington’s 39 counties.

Older Americans often hold onto the equity in their home as a nest-egg to deal with financial emergencies. But a reverse mortgage can be more than just a last resort. These loans give seniors new ways to plan for long-term care. This can be crucial for homeowners who could not prepare for this need with private insurance or savings. Funds from reverse mortgages also have the potential to strengthen community long-term care systems and reduce the growing strain on the state Medicaid budget.

## **Background**

Seniors have several choices to tap the equity in their home. A traditional home equity loan or line of credit can be useful for homeowners who are unsure how long they can continue to live at home. However, many seniors do not qualify for this type of loan because lenders look carefully at their income, other debt, and credit history. Conventional home equity loans also can be risky. Borrowers must be able to make monthly payments on these loans. If their health deteriorates and they cannot keep up with the payments, they could lose the house.

Many states and communities offer special loans that are designed to help seniors deal with substantial home repairs or property taxes. These loans work like a reverse mortgage, in that borrowers do not need to make payments for as long as they continue to live in the home. Such single-purpose loans are usually less expensive than other home loans. However, they may not be available to all seniors. In addition, the remaining equity in the home, which can be large, may not be accessible to pay for long-term care expenses.

Reverse mortgages work best for seniors who expect to live in their home for at least several years. The money borrowers receive is tax-free, and can be used for any purpose. Unlike conventional mortgages, there are no income requirements for these loans. Since borrowers do not have to make monthly mortgage payments, there is little risk that they will lose their home. In addition, reverse mortgages include several unique consumer protections.

In a recent study, the National Council on Aging estimated that of the nearly 28 million American households age 62 and older, almost half (48%), or about 13.2 million, are good candidates for a reverse mortgage. These older homeowners would be able to receive at least \$20,000 from a reverse mortgage to help them to age in place.

## **The Basics**

Reverse mortgages are special loans that allow people age 62 and older to convert a portion of their home equity into cash while they continue to live at home for as long as they want. These types of loans are called “reverse” mortgages because payments flow from the lender to the homeowner. Borrowers can select to receive payments as a lump sum, line of credit, fixed monthly payments (for up to life in the home) or in a combination of payment options.

Seniors with an existing mortgage and other debts may qualify for a reverse mortgage. The reverse mortgage can eliminate the need to continue to make monthly payments on that debt, freeing-up cash for help at home or other purposes. Reverse mortgage borrowers continue to own the home and are responsible for paying property taxes, hazard insurance, and maintaining the home. Borrowers do not need to make any loan payments for as long as they (or in the case of spouses, the last remaining borrower) live in the home as their main residence. When the last borrower moves out, dies, or stays in a nursing home for over 12 months, the loan becomes due. The borrower or the heirs can either pay the balance due on

the reverse mortgage and keep the home, or sell the home and use the proceeds to pay off the loan. Borrowers or their heirs keep any money left over from sale of the home, above and beyond the loan balance.

The most popular reverse mortgage is the federally insured Home Equity Conversion Mortgage (HECM), which represents 90 percent of the market today. HECMs have been available since the 1980's, as a program under the Department of Housing and Urban Development (HUD). The private sector also offers other reverse mortgages, including the HomeKeeper loan from Fannie Mae and Financial Freedom Cash Account loans.

Most of the costs of taking out a reverse mortgage are similar to those of a conventional home loan or to refinance an existing mortgage. These can include an origination fee and third-party closing costs (fees for services such as an appraisal, title search and insurance, surveys, inspections, recording fees). HECM borrowers are also required to pay mortgage insurance. Closing costs can be financed as part of the mortgage.

AARP played a key role in the development of the HECM program. As a result, there are many consumer protections for reverse mortgage borrowers. These include:

- Potential borrowers must first meet with a HUD-approved counselor before they incur any costs or their loan application can be processed.
- Upfront costs of the HECM loan are regulated, and there are limits on the total fees that can be charged.
- Lenders are required to give borrowers an estimate of the total loan costs over time.
- Borrowers or their heirs never owe more than the value of the house at the time of sale or repayment of the loan.

The amount that a homeowner can borrow is based primarily on the value of the home, the type of loan they select, the age of the youngest borrower, and the current interest rate.

## **The Problem**

Relying solely on income and savings creates a precarious financial situation for many seniors with a chronic health condition. A wide array of costly problems can arise when these elders preserve home equity and thus have inadequate resources to age in place. These can include:

1. Lack of prevention – Many older Americans cannot afford home modifications and other interventions that reduce the risk of preventable illnesses and accidents. Falls that require medical attention cost Medicaid about \$4 billion per year in hospital and long-term care expenses.
2. Unstable health – Out-of-pocket costs associated with unstable or declining health make it hard to maintain an adequate cash flow. As a result, elders may forego needed services and medications. Short, but frequent, nursing home stays can result in impoverishment over time.
3. No options - Families may quickly sell the home to cover an elder's mounting nursing home expenses. Some adult children also transfer title to the home to protect their inheritance. This can leave an impaired elder with no choice but to remain in the facility.

When the family budget becomes strained due to unexpected health expenses, impaired elders often turn to government for support. Due to the high cost of nursing home care, elders with moderate incomes who receive care in these facilities are at greatest risk for impoverishing themselves and needing to rely on Medicaid.

## **Barriers**

The decisions that older homeowners make about the timing and use of home equity can significantly impact the State's ability to better balance public and private funding for long-term care. Today few older Washingtonians use this asset for aging in place. This is because tapping home equity is often more than just a financial decision. It is also an emotional issue that can touch deeply held values. Many seniors and their families are also unfamiliar with reverse mortgages. They often have no idea why it would be worthwhile to use this loan to age in place.

Impaired elders have unique needs when deciding to take out a reverse mortgage. A chronic health condition can make it hard to know how much longer a person can continue to live at home safely and comfortably. These loans can be costly for borrowers who are only able to stay at home for a short period. Closing costs may add up to more than 5 percent of the value of the home.

While the amount of home equity owned by seniors is substantial, these funds will likely not be enough to pay for all their long-term care needs. Borrowers who spend their equity at an earlier stage will have fewer financial resources when they become more severely impaired. If their housing equity has been depleted, impaired elders may not be able to raise enough funds from selling the home to move into an assisted living facility or other supported housing environment.

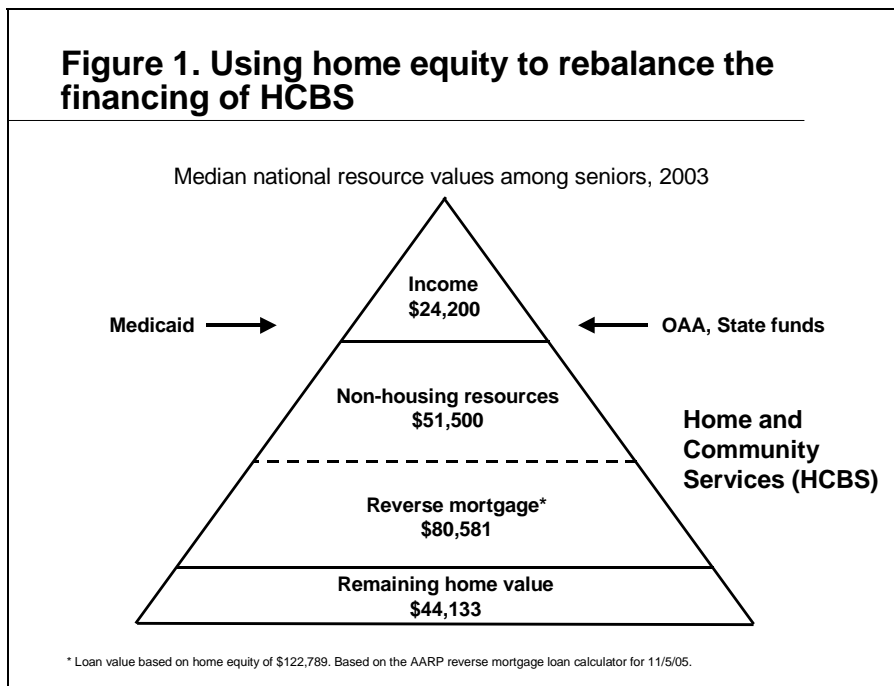
## **Reverse Mortgages as a Solution**

High levels of home ownership among older Washingtonians suggest that home equity may be a useful financing option for many impaired elders. Reverse mortgages can provide a strong foundation for aging in place (Figure 1). Consider the situation of Elinor Smith who lives in a house that is in good repair and is worth \$122,790 – the median home value nationally in 2003. She owns her home free of any debt. Her income of \$24,200 and non-housing retirement assets (\$51,500) are also typical of seniors in 2003.

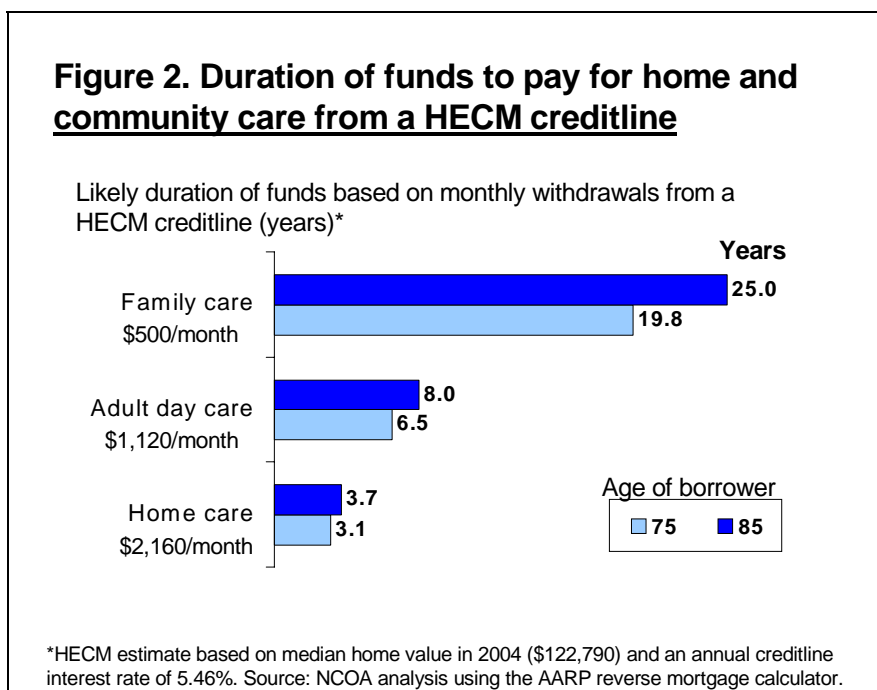
Elinor Smith (age 80) has arthritis, which makes it difficult to manage on her own. She pays a neighbor \$300 per month to help around the house. But when she needs more assistance from a home health aide, her monthly bill for services can be over \$1,000. At her age, Elinor receives \$80,518 from a reverse mortgage - more than double the amount of her other resources to pay for help at home. She selects the creditline payment option for her reverse mortgage. This allows her to tap these funds as needed, and only pay interest on the amount she uses. Elinor knows that she will benefit from any appreciation in the value of her home over time.

Encouraging the use of home equity could offer a more balanced approach to financing the services and supports needed by impaired elders who live at home. By getting a reverse mortgage, monthly income is more likely to remain available to pay for everyday expenses, including home modifications and repairs, that help to maintain quality of life for seniors. In

addition, there may be a substantial amount of home equity left over after the loan is paid for an inheritance or to help seniors move into more supportive housing, if needed.



Funds from a reverse mortgage can pay for help at home for many years. Nationally, the average home health aide charges about \$72 for a four-hour visit, which adds up to \$2,160 per month for daily care. Adult day care services cost on average about \$56 per day, or \$1,120 per month.



At these rates, a 75-year-old borrower who has a home worth \$122,790 may be able to use a reverse mortgage to pay for an adult day program for almost five years, or daily home care visits for about 6.5 years (Figure 2). These funds could also support family caregivers by paying for their out-of-pocket costs and respite care once per week (\$500 per month) for more than 19 years. Since lenders offer higher loan amounts at older ages, an 85-year-old borrower would be able to pay for more assistance or for longer periods.

### **Potential Approach**

To create a system that more effectively manages long-term care funding for community-based options, the Long Term Care Task Force could consider exploring and implementing a reverse mortgage model that offers another financing option to seniors. As part of this model, the State could offer incentives to encourage greater use of reverse mortgages among impaired elders. These incentives could be targeted to elders at greatest risk for needing Medicaid, and could include:

- Paying for some or all of the upfront loan costs, and/or servicing fees;
- Bundling reverse mortgages with social services such as care assessment to help borrowers use their funds effectively for aging in place;
- Making it easier for reverse mortgage borrowers to participate in established community-based programs in Washington State; or
- Providing back-end protection to impoverishment through a program modeled on the LTC Partnership Program.

Incentives could be linked to the existing HECM loans, or could be incorporated into a state designed and run reverse mortgage program for long-term care. These efforts could open new possibilities for a more coordinated approach that can reduce the risk of institutionalization, compliment Medicaid, and enhance quality of life for older adults in Washington State.

## **Reverse Mortgage Fact Sheet**

**Published by the Washington State Department of Financial Institutions**

### **What is a reverse mortgage?**

A reverse mortgage is a home loan that allows seniors to convert a portion of the equity in their home to cash while they continue to live there for as long as they want. These loans are called “reverse” mortgages because payments flow from the lender to the homeowner. Borrowers do not have to pay back the loan for as long as they continue to live in the home. Proceeds from a reverse mortgage are tax free, and can be used for any purpose.

### **Eligible Homeowners**

- All homeowners must be at least 62 years old.
- The home must be a borrower’s primary residence. This means that at least one owner must live in the house most of the year.
- Homeowners who have an existing mortgage or other debts may qualify for a reverse mortgage. The reverse mortgage would be used to pay of the existing loan and eliminate monthly payments. Any remaining funds could be used for any purpose.

### **Eligible Homes**

- Single family, one-unit dwelling.
  - Two-to-four unit, owner-occupied dwelling.
  - Some condominiums, planned unit developments or manufactured homes.
- NOTE: Cooperatives and most mobile homes are not eligible.

### **How do reverse mortgages work?**

- Borrowers make no payments for as long as they live in the home.
- The loan can be repaid at any time without penalty. It comes due when the last borrower dies, sells the home, or permanently moves away.
- Because borrowers make no monthly payments, the loan amount increases over time. However, borrowers or their heirs never owe more than the home's value at the time the loan is repaid, even if the value of the home declines.
- Borrowers continue to own the home, and are responsible for property taxes, insurance, and maintaining the home. If they fail to pay these expenses, the lender can use the loan to make payments or require the borrower to pay the loan in full.
- Because reverse mortgage payments are proceeds of a loan, these funds do not count as income for Medicaid eligibility in the month they are received. Any payments that remain unused beyond that month would count as a resource and could affect eligibility for benefits under Medicaid. Funds in a line of credit are not counted by Medicaid until they are actually used.

### **How much will I get with a reverse mortgage?**

- The amount of the loan depends on the youngest borrower’s age, the value of the home and its location, any needed home repairs to meet FHA minimum requirements, and the cost of the loan.
- Reverse mortgage borrowers can select to be paid:
  - All at once in cash;
  - As a monthly payments, for up to life in the home;
  - As a credit line that lets them decide how much they want to use and when;
  - In any combination of the above payment options. Borrowers can easily change their payment plan.

**Types of Reverse Mortgages**

- Home Equity Conversion Mortgage (HECM) – This program is offered by the Department of Housing and Urban Development (HUD) and is insured by the FHA. HECMs are the most popular reverse mortgages, representing about 90% of the market.
- Fannie Mae Home Keeper loan - Borrowers can receive more cash from these loans than with a HECM since the loan limit for this product is higher.
- Financial Freedom Cash Account loans – This product is an option for seniors who own homes that are worth more than \$600,000.

**Costs of Reverse Mortgages**

- The costs associated with a reverse mortgage can include the following:
  - Origination fee
  - Closing costs
  - Mortgage Insurance (for HECM loans)
  - Monthly service fee
  - Interest paid on the loan balance
- Closing costs can be included in the loan.

**Consumer Protections**

- Potential borrowers must first meet with a HUD-approved counselor before they incur any costs or their loan application can be processed.
- Upfront costs of the HECM loan are regulated, and there are limits on the total fees that can be charged.
- Lenders are required to give borrowers an estimate of the total loan costs over time.
- Borrowers or their heirs never owe more than the value of the house at the time of sale or repayment of the loan.

**For More Information, visit AARP:** Understanding Reverse Mortgages at [www.aarp.org/revmort](http://www.aarp.org/revmort)

"*Home Made Money*," a free booklet by AARP, is available by calling 1-800-209-8085 or writing AARP Fulfillment, 601 E Street, NW, Washington, DC 20049. Ask for stock number D15601.

The National Council on Aging offers free consumer guides for people who are considering a reverse mortgage for immediate needs, and to plan ahead for aging in place, at [www.ncoa.org](http://www.ncoa.org)

Available at: <http://www.dfi.wa.gov/consumers/reversemortgage.htm>